



Wealth Watch



2021: Q3 Review & Q4 Outlook

As we enter autumn and welcome the alluring colors and climate of the season, we reflect upon the timeless pastimes of summer. Memories abound of days spent on the beach, hikes through the mountains and, of course, the enjoyment of carnivals and circuses.

The Greatest Show on Earth

The iconic slogan of Ringling Bros. Barnum & Bailey Circus encompasses the many thrills of investing. The third quarter of 2021 felt like a carnival at times, particularly the rollercoaster ride-like volatility of September. Indeed, the final week of that month witnessed the first 5% decline in nearly a year!

As we enter the final quarter of 2021 we ponder whether another roller coaster awaits or are we in store for a leisurely upswing on the Ferris wheel? The past year has undoubtedly witnessed an astounding recovery from the pandemic lows, both in the economy and the capital markets. What could potentially derail this growth going into 2022? There are five factors presently in play—a “Five-Ring Circus,” if you will—which we seek to consider.



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What You Need To Know:

- September was negative but Q3 was positive and the market may rally in late 2021
- WestStar's proactive tactical positioning has been prescient and has added value to client portfolios
- The recent pandemic uptick may have been the final surge
- The Fed will likely begin tapering in Q4 and throughout 2022 while federal stimulus may decline
- Inflation still appears transitory though may run a bit above recent years' levels
- Supply chain issues are likely to normalize into 2022
- Corporate earnings may be under pressure in the new year

Your wealth, well managed.

Commodities 29.13%
US Large Cap Stocks 15.92%
Real Estate 15.26%
US Small Cap Stocks 12.41%
International Developed Market Stocks 8.35%
High Yield Bonds 4.53%
Alternative Investments 4.08%
Money Market (Cash) 0.08%
International Emerging Market Stocks -1.25%
US Investment-Grade Bonds -1.55%
International Bonds -5.94%

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Market Performance: "Riding the Rollercoaster"

The S&P 500 witnessed the first 5% downturn in 11 months in late September, bringing an end to the 13th-longest winning streak on record and the seventh consecutive monthly gain for that index. Despite this fact, the S&P 500 was slightly positive in Q3 at +0.2% and the Index continued to outperform bonds for its sixth consecutive quarter. US stocks outpaced International while Growth style led Value. Commodities were the top-performing of all categories while Emerging Markets stocks were the bottom. Year-to-date all major categories are positive with the exception of Bonds, though within that category High Yield remains the lone winner.

The late September decline is consistent with history, as it has been the weakest of all months in the market on average. However, analysis conducted by our strategy consultant Ned Davis Research indicates a less than 1-in-3 probability of a 5% dip devolving into a 10% one based on all market declines going back to 1928. Moreover, they find that December tends to be the strongest of all months historically. Like roller coasters, investing involves ups, downs, frights and delights. While both may, at times, stir nervousness or even nausea, one must complete the ride to reap the rewards.

Tactical Strategy: "The High Striker"

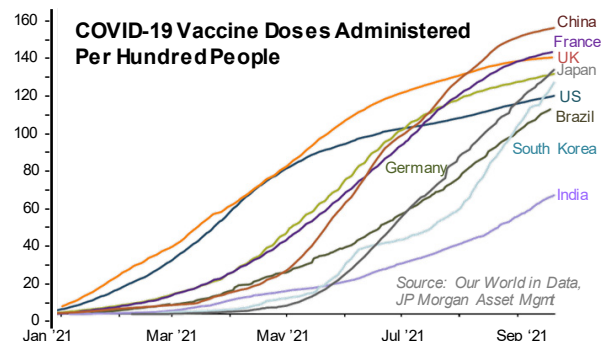
"Step right up and test your strength!" is a common refrain heard on the carnival midway by operators of the "High Striker" hammer and bell game. We continually strive to identify areas of opportunity and risk and proactively adjust our investment strategies accordingly. Our tactical positioning has been very strong in the COVID era, having been underweight stocks at the nadir of the downturn, overweight stocks since April of 2020, underweight bonds generally but overweight High Yield, and having increased exposure to Real Assets in January 2021. We also adeptly shifted between Large Cap vs. Small Cap and Growth vs. Value as warranted. As of this writing we are maintaining our current tactical strategy, as we believe it is properly positioned for the fourth quarter of 2021.

Factors Currently Affecting Markets: "The Five-Ring Circus"

Ringling Bros. Barnum & Bailey had a world-famous three-ring circus to impart the magic and wonders of the "Big Top" to their audiences. As investors look upon the current state of the global markets and economy they encounter a five-ring circus of interrelated factors affecting the state of their finances in late 2021 and early 2022.

1. COVID Pandemic

The primary influence on markets and global growth has undoubtedly been the pandemic. The US experienced a spike in cases in the summer amid the spread of the Delta variant, yet this may prove to have been the last surge (barring some new variant). By some estimates, over 80% of Americans have now either had the virus, been vaccinated against it, or both, indicating a substantial level of immunity among the population. This increasing immunity is a global phenomenon as seen on the chart at right, indicating opportunity abroad and in some cases beyond that in the US. This along with economic adaptation suggests negative COVID effects will continue to wane.



US Large Cap Stocks: S&P 500 Index; US Small Cap Stocks: Russell 2000 Index; Int'l Developed Market Stocks: MSCI EAFE Index; Int'l Emerging Market Stocks: MSCI Emerging Markets Index; US Investment-Grade Bonds: Bloomberg Aggregate Index; Int'l Bonds: Bloomberg Global Aggregate ex-USD Index; High Yield Bonds: Bloomberg US Corporate High Yield Index; Money Market (Cash): BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodities: Bloomberg Commodity Index; Alternative Investments: Wilshire Liquid Alternatives Index

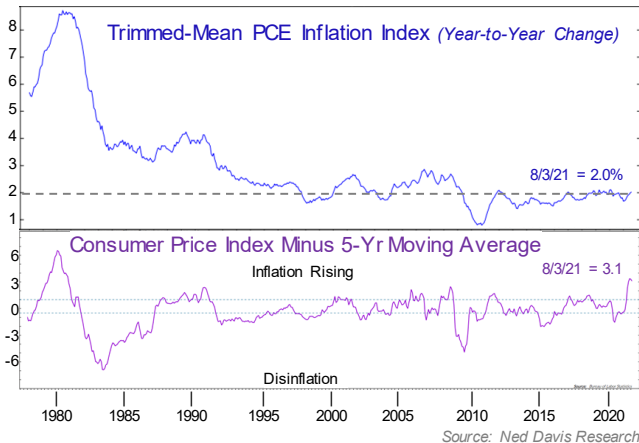
2. Fiscal Stimulus & The Fed

The tremendous amount of money injected into the economy in response to the COVID crisis was a true ballast to what would have otherwise been utterly disastrous. Its stimulative effects have also helped boost the stock market. The question then becomes, what happens when said stimulus is withdrawn? Currently on the table in Washington are the dual infrastructure and reconciliation bills amounting to a combined \$4.5 trillion. Should passage of these bills fail coinciding with the expiration of the first COVID stimulus measures, the absence of stimulus could become a headwind. Meanwhile, economic growth will likely accelerate in the fourth quarter, unemployment is declining, and inflation is running hotter than expected, indicating a high likelihood the Fed will begin tapering its bond purchases in late 2021, have zero purchases by next summer, and may look to raise interest rates in late 2022.

3. Inflation

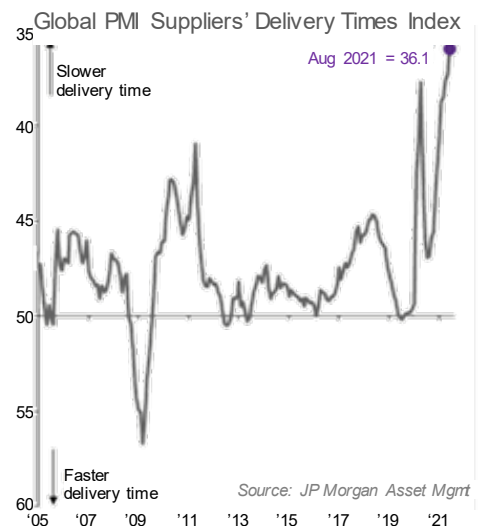
The aforementioned Fed timeline seems to be the general consensus, though the fear of sustained high inflation rate could incite an expedited hike. That being the case, where do we stand with regard to inflation? The top chart at left shows that

a measure of “core” PCE inflation (the Fed’s preferred indicator) has been running at 2%, suggesting scant reason to worry about inflation getting beyond control despite higher wage growth and current global supply/demand imbalances. Furthermore, the elements contributing to disinflation over the past two decades (i.e. technology, globalization, demographics and high debt levels) remain intact. In other words, at this juncture it appears that inflation is likely to abate from current levels though it may sustain a 2%+ range rather than the 2%- one of the past several years. That said, periods of higher inflation have historically been a drag on stock returns, with an average annual gain of -1.15% when the measure in the bottom chart at left is above 1.0. The wildcards of inflation remain wages, housing costs and supply chain issues.



4. Supply Chain

Among the most discussed and fretted issues facing investors currently is the delays in the global supply chain. The chart at right shows that delivery delays across 44 countries around the world are at unprecedented levels. Again, the root cause of this issue is the immense imbalance between supply and demand caused by the pandemic. As previously discussed, massive stimulative measures instituted to counterbalance COVID bolstered household balance sheets but simultaneously the shutdown and work-from-home environment shifted demand from services to durable goods. Suppliers were unable to adapt as quickly as demand and general uncertainty surrounding the overall situation led to miscalculations in ordering and manufacturing. Despite the dim current climate, the anticipated fading COVID spread, diminished governmental stimulus, a potentially decelerating global economy in 2022 coupled with suppliers ramping up production should have the twin effects of expedited delivery times and lower prices (i.e. inflation).



5. Earnings

In last quarter's edition of the Wealth Watch we noted the large contribution of corporate America's record profits to the recent stock market success. What is outlook for earnings in 2022? Rising wages could pressure profit margins—the largest factor in recent earnings strength—as could potential corporate tax hikes. Corporations are in a position to defend margins to a degree and tax hikes remain tenuous going into a mid-term election year, but these are factors upon which we will maintain a close eye.

Remain Focused on Long-Term Strategy: “Hit the Target and Win the Prize!”

Among the five-ring circus factors, the positives outweigh the negatives and a market rally in Q4 may be expected. On a longer-term basis, every investor must determine the appropriate strategy to employ given one's unique needs and objectives. As it relates to our carnival theme, everyone must decide whether to ride the rollercoaster (an aggressive strategy), the merry-go-round (a conservative strategy), or somewhere in between. Perhaps the most applicable analogy would be playing the midway games. Prudent investing is intended to identify a target which we strive to hit to “win the prize.” We remain committed to helping you stay focused on your target and play the game to win.

The team you can trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.



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